Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department
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INTERNATIONAL TRENDS & OTHER DEVELOPMENTS AFFECTING THE U.S. SECURITIES INDUSTRY [1]

Highlights

1. The U.S. securities industry outperformed U.S. manufacturing's ROE until 1987. Since the 1987 Crash, the story has been quite different with the securities industry considerably underperforming manufacturing until this year's first quarter.

2. Prior to the Crash, 15% to 25% of all NYSE member firms showed quarterly losses. Since then, roughly one-third to one-half of all firms showed quarterly losses until 1991 when rallying markets reduced the number to only 19%.

3. Well over a half a trillion dollars of U.S. equities was taken out of the market since 1984 through mergers, acquisitions, and other corporate restructurings. That this equity was replaced with debt, on top of escalating federal borrowing, remains a real concern to many. Fortunately, for the first time since 1984, there has been an increase in the supply of equity this year.

4. For much of the 1980s, U.S. interest in foreign securities was small, averaging $6.5 billion annually from 1980-88. Last year, net purchases reached a record $31 billion, following a then record $19 billion in 1989.

5. Gross cross-border capital flows increased substantially through the 1980s. In recent years, countries with large and persistent occurring account deficits attracted foreign capital (unlike earlier years), thus weakening pressures for policy adjustments. Nowhere was this more true than in the U.S., where foreign capital substituted for savings and internal investment.

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1 This issue of *Trends* excerpts observations and commentary about the current and future state of the securities industry from a presentation by Jeffrey M. Schaefer, SIA Senior Vice President and Director of Research, before the July 17 Asian Securities Industry Institute, Manila, Philippines. SIA welcomes contributions to *Trends* from all sources, from member firms as well as others, relating to the securities industry and capital markets. Please send submissions to the attention of Jeff Schaefer or George Monahan, SIA Research Department.

Securities Industry Association

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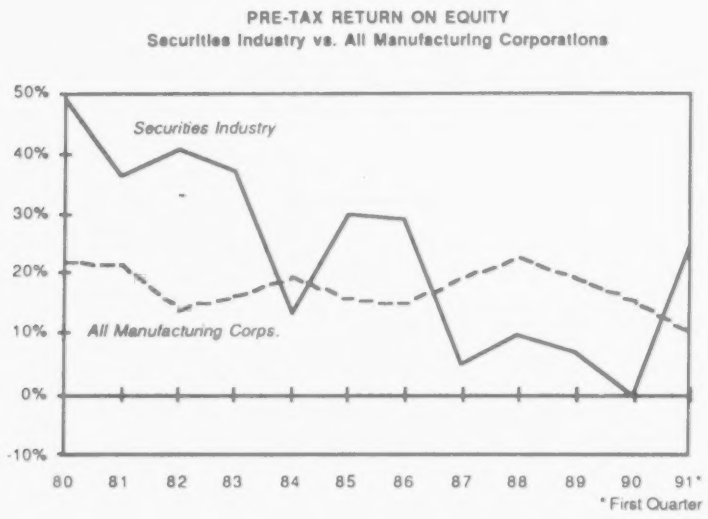
INTERNATIONAL TRENDS & OTHER DEVELOPMENTS AFFECTING THE U.S. SECURITIES INDUSTRY

For most of the 1980s, the U.S. securities industry outperformed U.S. manufacturing considerably, as seen below. Despite the downward trend in pre-tax ROE, the securities industry outperformed manufacturing until 1987. Since the 1987 Crash, the story has been quite different with the securities industry underperforming manufacturing in the U.S.



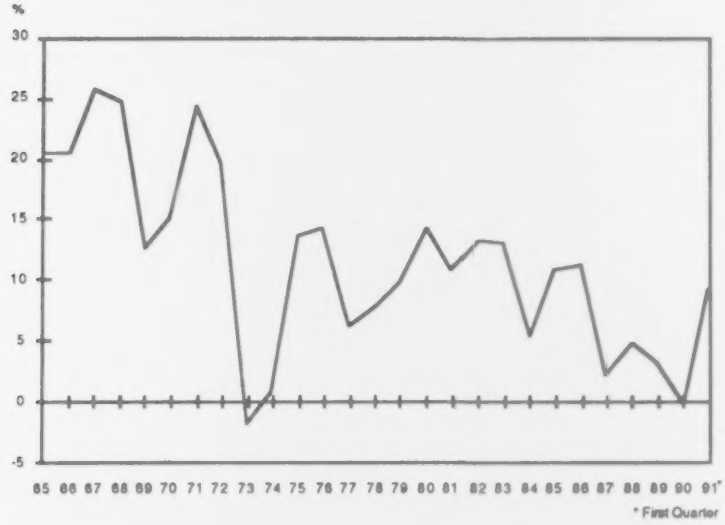
Indeed, things deteriorated so badly in 1990 that the securities industry actually lost money. However, the strong first quarter of 1991 put us back to the pre-1987 trend, where the securities industry outperformed U.S. manufacturing. Furthermore, the 25% ROE earned during 1Q91 was only slightly less than the boom years of 1985-1986. Of course, it is still interesting that despite the strong performance during the first quarter which continued, to some extent, during 2Q91, the pre-tax ROE still was below that achieved during the early 1980s.

The U.S. securities industry's profit margin has generally trended downward since data became available in 1965. In 1967, pre-tax margins were 25%, or in other words, firms kept 25¢ of every $1 of revenues generated before the payment of taxes. This was the highest margin on record.

Although the securities industry grew rapidly in the 1980s and generated record revenue year after year, strong competition and the resultant narrowing of spreads

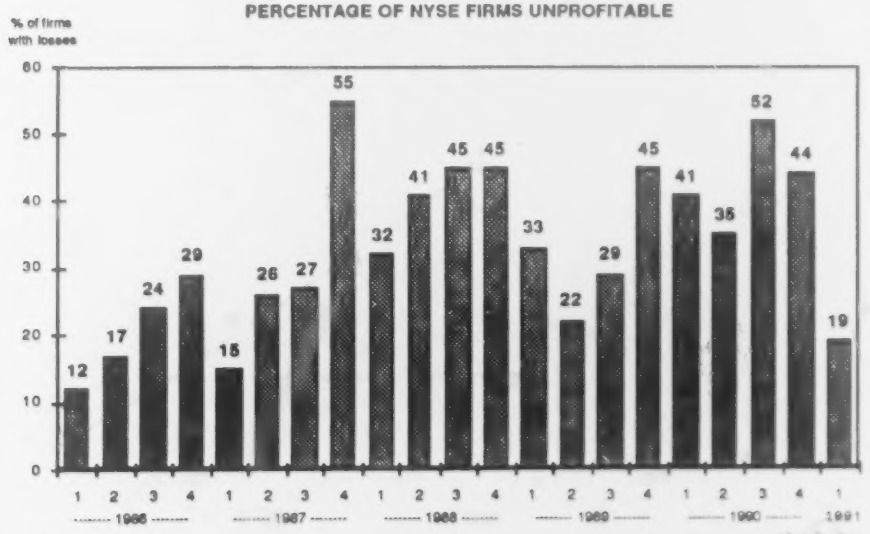
earned in businesses led to declining margins, which were exacerbated by the Crash. The first quarter 1991's profit margin of 9.5% reversed this trend, at least temporarily.

SECURITIES INDUSTRY PRE-TAX PROFIT MARGIN



Prior to the worldwide stock market Crash of 1987, about 15% to 25% of all New York Stock Exchange member firms showed quarterly losses. During the Crash-impacted fourth quarter of 1987, over half of these firms lost money. Since then, roughly one-third to one-half of all firms showed quarterly losses until 1991 when rallying markets reduced the percentage of the NYSE's members with losses to only 19%.

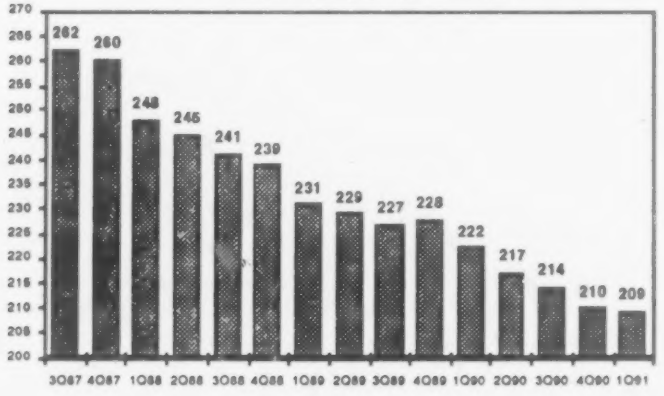
PERCENTAGE OF NYSE FIRMS UNPROFITABLE



From late 1987 through 1990, many securities firms closed or merged and most of the remaining firms were forced to downsize their business in order to survive. Employment fell to 209,000 by the first quarter of 1991, a loss of 53,000 jobs or 20% of the workforce in just over three years. Meanwhile, total capital dropped from a peak of $39.3 billion at year-end 1989 to $36.3 billion during 1Q91 due to a shrinkage in the number of players and charge-offs to capital from frequent quarterly losses.

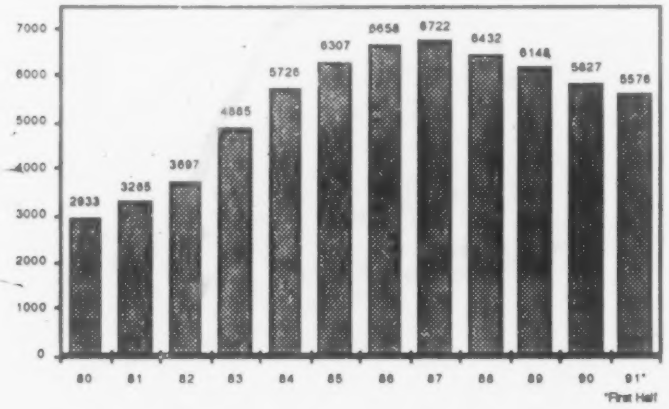
SHRINKING EMPLOYMENT SINCE THE CRASH

Securities Industry Employment in Thousands



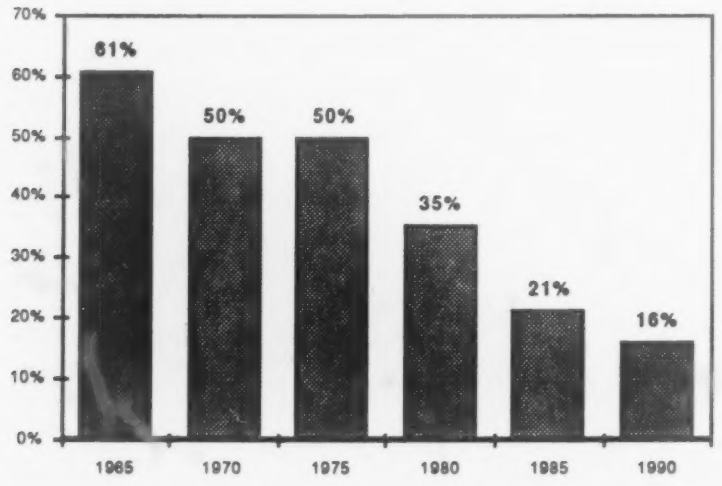
As mentioned, over the three years that one-third to one-half of all NYSE members incurred these quarterly losses, many firms closed or merged and most of the remaining firms were forced to dramatically downsize in order to remain in business. After peaking at 6,722 firms at year-end 1987, the number of NASD members fell to 5,576 by June 1991, a 17% contraction.

NASD MEMBER FIRMS



For several decades, the commission business has declined in relative importance to the U.S. securities industry. Over 60% of all revenues came from commissions in 1965. Half of all securities industry revenues still came from commissions in 1970 and 1975, the year fixed commission rates on U.S. stock exchanges were abolished.

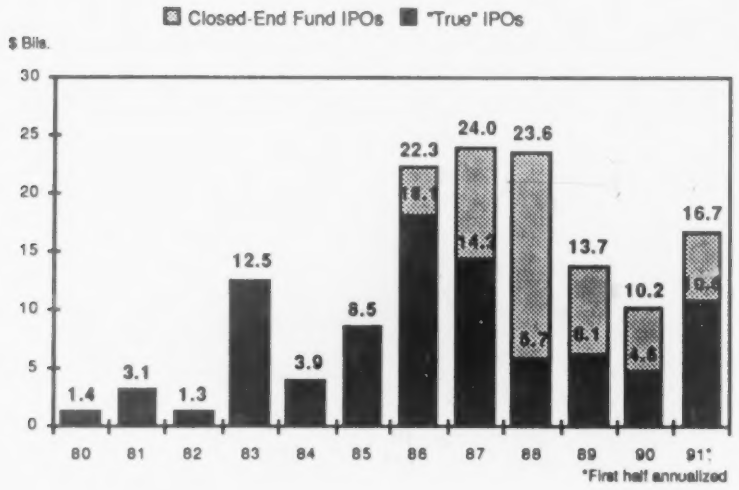
COMMISSIONS' SHARE OF INDUSTRY REVENUES



Today, commissions account for only 16% of total industry revenues. Total commission *dollars*, however, did not decline until after the 1987 Crash. What occurred was an explosive growth in other business line revenues relative to the slow growth in commission business. The decline in the relative importance of the commission business, a safe agency line of business, forced firms to seek profitability through more risky, principal lines of business such as trading, mergers & acquisitions, merchant banking, etc.

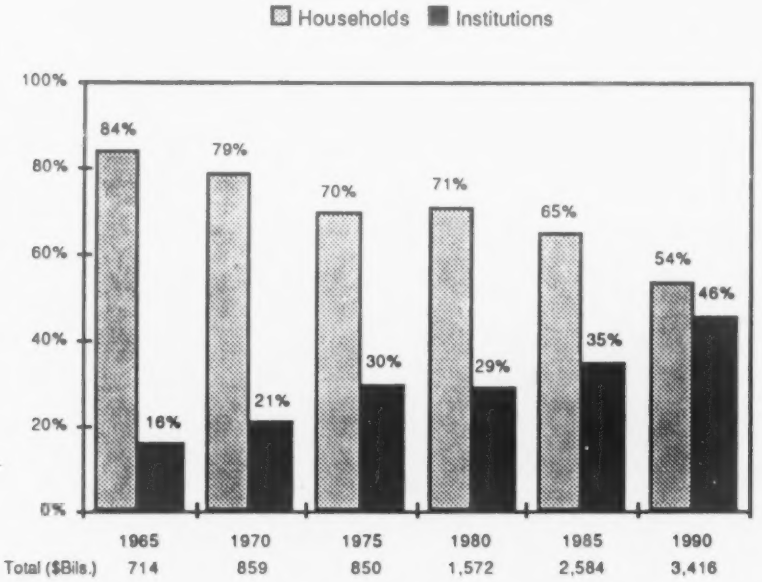
For new companies trying to raise capital via initial public offerings (IPOs) of stock, the 1987 Crash was an unqualified disaster. In the three years immediately following the crash, the total of "true IPOs" (exclusive of closed-end fund IPOs) raised over the entire three years (1988, 1989 and 1990) was less than that raised in 1986 alone. Over $5 billion in true IPOs have already been offered in the first half of 1991, more than was done for *all* of last year ($4.6 billion).

INITIAL PUBLIC OFFERINGS



In 1965, households held 84% of equities outstanding, and institutions 16%. By 1990, shareownership by individuals had dwindled to 54%. The "institutionalization" of the marketplace can be seen in the growing share of equities held by institutional investors, which has broad ramifications for market liquidity, volatility, etc.

HOLDINGS OF U.S. EQUITIES



By 1990, private pension funds held 40% of all institutional holdings of equities in the U.S. To give some idea of the difference in holdings of the two largest categories, individuals held $1.9 trillion while pension funds owned $0.6 trillion of equities. After private pension funds, public pension funds, mutual funds, and foreign investors are the next largest institutional holders of U.S. equities. Still, stock market trading is dominated by institutions because of higher turnover of their portfolios. According to our figures, institutions account for 70% of volume on the NYSE.

Well over a half a trillion dollars worth of equity in U.S. corporations was taken out of the stock market since 1984 through LBOs, other mergers and acquisitions, and other corporate restructurings. Many believe that this reduced supply of equities helped buoy the strong upward rally in stock prices throughout much of the 1980s.

NET ISSUANCE OF SECURITIES
(New Issues Less Retirements in $ Billions)

	Corporate Equities	Corporate & Foreign Bonds	Total U.S. Government Securities
1970	7.7	23.3	21.7
1975	10.9	36.7	94.9
1980	14.9	30.5	122.9
1981	(10.5)	34.3	133.0
1982	7.9	39.0	225.9
1983	27.3	37.7	254.4
1984	(69.8)	84.2	273.8
1985	(67.2)	128.2	324.2
1986	(72.2)	212.8	369.5
1987	(63.0)	165.7	317.5
1988	(125.3)	161.5	277.2
1989	(105.1)	115.8	302.6
1990	(49.7)	126.7	443.1
1991*	11.2	132.4	370.7

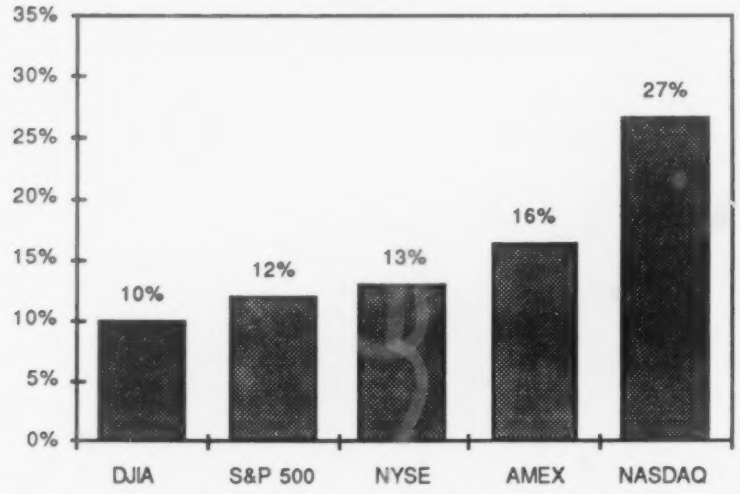
*First Quarter Annualized

That this equity was replaced with debt, on top of the escalated borrowing of the U.S. government to finance increasing deficits remains a real concern to many economists and businessmen insofar as the recovery of the economy and markets is concerned. Fortunately, in 1991, for the first time since 1984, there has been an increase in the supply of equity, a sharp contrast to the trend since 1984.

After a year (1990) which saw all major stock market indices decline anywhere from 4% on the Dow Jones Industrial Average to nearly 20% on the American Stock Exchange and NASDAQ Composite Indices, 1991 so far has seen market levels rise strongly across-the-board. The Dow was up 10% in the first half, erasing last year's loss and then some, while NASDAQ was up 27% reflecting the strong institutional and retail interest in smaller capitalized companies. All other major indices were also up somewhere between these two ranges.

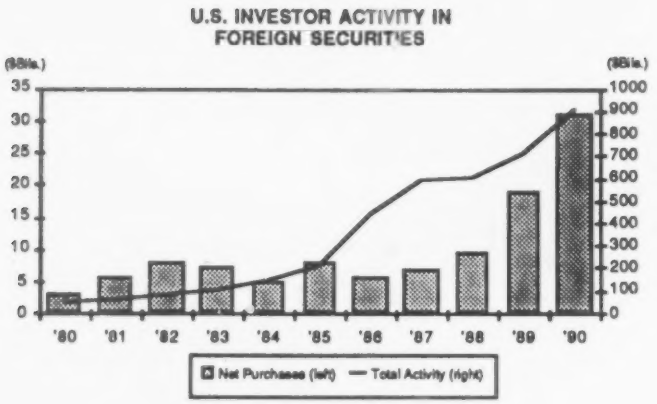
PERCENT CHANGE IN STOCK PRICES

First Half 1991

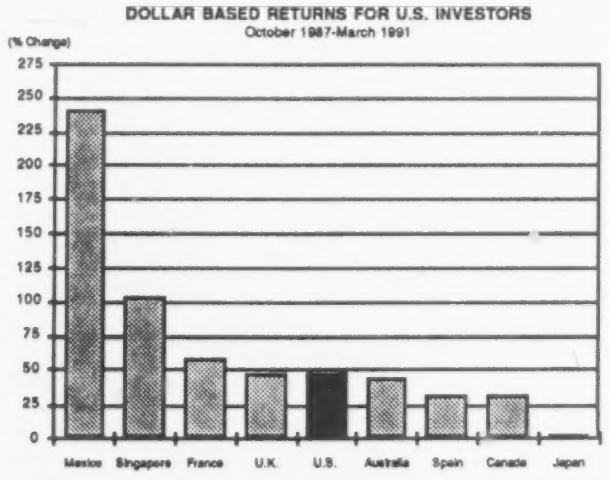


For much of the 1980s, U.S. interest in foreign securities was nowhere near the interest foreigners had in U.S. securities. For example, during the period 1980-1988, net purchases by U.S. investors in foreign securities averaged $6.5 billion. In 1990, net purchases reached a record $31 billion, following a then record $19 billion in 1989. The increased U.S. interest was a function of several variables, including the expectations for Europe 1992, developments in Eastern Europe, strengthening foreign currencies relative to the dollar, and finally U.S. institutions taking seriously a stated long-term goal: namely, greater portfolio diversification.

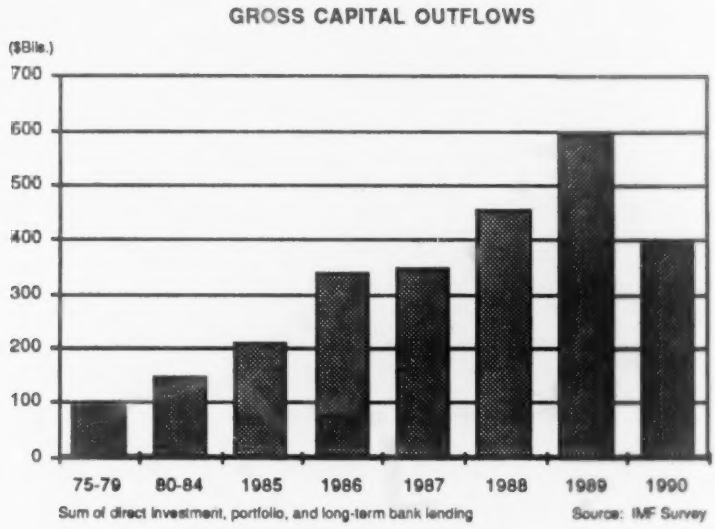
The appetite of U.S. investors for different foreign securities changed recently. In 1989, U.S. investors had record net equity purchases of $13.1 billion while net foreign bond purchases totalled $6.0 billion. In contrast, in 1990 there were record U.S. purchases of foreign bonds of $22.4 billion while net equity buys fell to $8.4 billion.



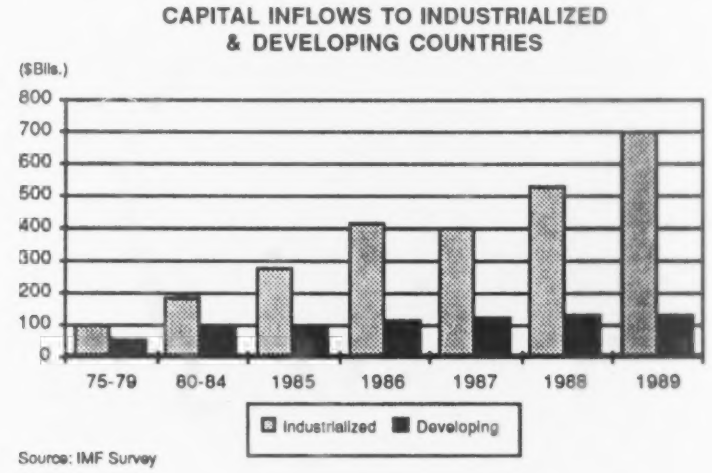
Mexico and Singapore led the markets in terms of dollar based returns since the Crash. Among the developed markets, France, the U.K. and the U.S. were the best performing markets. Except for Mexico and Singapore, the returns in the equity markets have been unimpressive and may explain many of the problems of the securities industry throughout the world in trying to attract investors, particularly when real interest rates were at record levels, especially in the U.S.



A recent Bank for International Settlements (BIS) report indicates that cross-border gross capital flows increased substantially through the 1980s. This basically was a reaction to deregulation, internationalization and technology. In recent years, countries with large and persistent occurring account deficits continue to attract foreign capital (unlike earlier years), thus weakening pressures for policy adjustments. Nowhere was this more true than in the U.S., where foreign capital substituted for savings and internal investment.



The same BIS study indicates that it was mainly the developed or industrial countries that reaped the benefits of capital inflows in the 1980s. The amount of money going to the emerging markets held more or less stable since early 1980. The increase in flows to developed countries was a combination of increased portfolio investment and direct investment offsetting declines in bank lending.



Developing countries may have to do a lot to improve the efficiency of their markets as well as to liberalize investment policies in order to encourage the kinds of portfolio flows (a more mobile form of capital than bank loans) that are needed given the sharp plunge in overseas bank lending in recent years.

Conclusion

Although much of the publicity about the securities industry in the 1980s revolved around mergers and acquisitions, LBOs, and direct investments in corporations, the actual time span that these activities dominated industry profitability was fairly short. In 1987-1989, these activities flourished. The same misconception is often made about mutual funds because equity mutual funds dominated other funds for several years. Only in the middle 1980s did equity mutual funds increase more than money market and bond funds. After the Crash, investment in equity mutual funds was actually negative as individuals switched out of equities into bond and money market funds. As short-term rates remained high in the U.S., individuals had little incentive to switch from short-term maturities such as money market funds. This behavior changed noticeably when the Federal Reserve reduced interest rates in late 1990 and February 1991 and in early August, as short-term rates lowered substantially while long-term rates remained relatively high.

If we analyze the industry's profitability during the 1Q91, it was attributable almost solely to a dramatic surge in trading profits and an increase in commission revenue. Costs remained controlled mainly because interest expense, the single largest expense of the U.S. securities industry, was more or less constant as interest rates were declining in 1991. This demonstrates how volatile the securities industry is as both trading and commissions, the main revenue sources of the industry in the 1970s and early 1980s, were flourishing in 1991 while the new products that accounted for much of the profits in the 1980s, had not recovered by mid-1991.

One of the main businesses that rebounded was raising capital for companies going public for the first time. If the 1991 pace continues, the amount of money raised for IPOs will be close to the peaks reached in 1986 and 1987. In any event, this is a healthy sign that the U.S. equity markets can respond to new and dynamic companies under appropriate conditions.

Finally, after a year where all the major stock market indices declined from 4% on the Dow to nearly 20% on the American Stock Exchange and over 27% on NASDAQ; in

1991, market levels have risen strongly across-the-board so far. The Dow was up 11% in the first half, more than erasing last year's loss. NASDAQ is up 27% reflecting the strong institutional and retail interest in smaller capitalized companies. All other major indicies were up somewhere between these two ranges. Hopefully, these trends will continue, helping the U.S. securities industry prosper.

Jeffrey M. Schaefer
Senior Vice President &
Director of Research

Grace Toto
Research Associate

VOLUME

	JUNE 1991	YTD 1991	JUNE 1990	YTD 1990	% CHG YTD 1991-1990
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	163.0	183.4	153.6	155.8	17.7%
AMEX (MILS.)*	11.5	13.1	12.4	14.0	-6.6%
NASDAQ (MILS.)*	142.7	162.0	150.1	139.2	16.3%
REGIONAL EXCHANGE (MILS.)*	25.1	28.5	24.3	24.9	14.6%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$112,457	$764,267	$115,622	$687,021	11.2%
AMEX (MILS.)	2,972	18,604	3,169	20,230	-8.0%
NASDAQ (MILS.)	46,976	327,210	44,887	242,182	35.1%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.8%	49.9%	49.9%	50.1%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,593	64,857	10,745	64,443	0.6%
AMEX OPTIONS	2,284	16,551	2,544	17,947	-7.8%
COMMODITY	21,773	131,344	22,004	139,747	-6.0%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	JUNE 1991	JUNE 1990	% CHG JUNE 1991-1990
DOW JONES INDUSTRIALS	2906.75	2880.69	0.9%
STANDARD & POOR'S 500	371.16	358.02	3.7%
NYSE COMPOSITE	203.47	195.48	4.1%
AMEX MARKET VALUE INDEX	358.12	361.21	-0.9%
VALUE LINE COMPOSITE	234.36	245.97	-4.7%
NASDAQ COMPOSITE	475.92	462.29	2.9%

YIELDS
(MONTHLY AVERAGES)

	JUNE 1991	JUNE 1990	BASIS POINT CHG 1991-1990
BOND BUYER INDEX (20 BOND)	7.13%	7.24%	(11)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.01	9.26	(25)
Baa CORPORATE	9.96	10.22	(26)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.91	(1)

UNDERWRITING

	FIRST HALF 1991	FIRST HALF 1990	% CHANGE 1991-1990
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$262,100.2	$163,912.6	59.9%
Common Stock	$26,002.4	$12,891.5	101.7%
# of Common Stock Issues	374	247	51.4%
Preferred Stock	$6,006.4	$2,846.3	111.0%
# of Preferred Stock Issues	60	51	17.6%
Corporate Debt	$230,091.4	$148,174.5	55.3%
# of Corporate Debt Issues	1,030	663	55.4%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$53,196.7	$43,873.0	21.3%
# of Issues	2,700	2,269	19.0%
Competitive	$20,250.3	$16,214.5	24.9%
# of Issues	2,019	1,787	13.0%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Report on Production & Earnings of RRs in 1990	This is a survey of retail and institutional production in 1990 as well as the earnings of salespersons. The 1990 edition is the 18th issue of this survey. The data is based on information provided by 57 SIA member firms. Information is provided on production, payout ratios, earnings, ticket size, branch manager earnings, etc.	SIA Survey Department Author is Pam Faber. Extra copies are available to the 57 participating firms at $50 per copy. For firms which did not participate, the price varies depending upon a firm's number of RRs and ranges from $250 to $625. For firms which are not SIA members, the price for the first report is $1400. Checks should be sent to: SIA, 120 Broadway, 35th Floor, NY, NY 10271
SIA Yearbook 1991-92	This issue of the yearbook is the 12th annual guide to the securities industry as represented by the SIA membership. The yearbook is a basic source document on individual firms and contains important aggregate information on the securities industry. Each year, the yearbook updates firm lists so that information is provided on SIA members owned partially or wholly by organizations not themselves involved in the U.S. securities industry, provides information on mergers and acquisitions involving SIA members and provides a list of firms that clear for other organizations. SIA members $65, non-member $100.	SIA 120 Broadway-35th Floor New York, NY 10271 Attention: Rosalie Pepe

Item	Description	Source
"The Silent Depression"	This article questions whether the standard definition of recession or depression in the U.S. -- two successive quarters showing declines in real GNP -- is appropriate anymore. The paper suggest that a different measure of recession or depression would be more appropriate -- the real income of the average worker or family. Real income is stressed because this measure covers living standards, and the standard of living is the best measure of economic progress. With a different measure of recession, the economic performance of the U.S. is less satisfactory. More interestingly, the paper discusses the reason for declines in our standard of living in the U.S.	Challenge Magazine July/August 1991 issue 80 Business Park Drive Armonk, NY 10504
Eastern Europe: The Wealth of Lessons	This paper discusses the ease or difficulty with which socio-economic changes can be introduced. The paper notes that there is friction brought about by major social changes. When these changes are taking place, friction is high. The paper's author is concerned that the post-communist transition from central economies to freer, market forces causes major frictions that have been overlooked where such changes were urged since 1989. Many economists assume that human adjustments to new economic rules will be swift and relatively simple. They often overlook the fact that human responses may be considerably slower and difficult in practice.	Challenge Magazine July/August 1991 issue 80 Business Park Drive Armonk, NY 10504
New York's Most Unjust Tax	The author argues that New York City's property tax rates are among the highest in the country, especially for apartments and commercial buildings. He also notes that these property taxes are regressive, destructive of the housing stock, and particularly troublesome for businesses especially new ones. In the current climate, the writer believes the New York's high rates actually may cost the city money. The author concludes that thoughtful reform of NY's property tax would cost the city very little and pay dividends in a short span of time.	New York City Journal 52 Vanderbilt Avenue New York, NY 10017 Telephone # 212/988-7300

Item	Description	Source
A Survey of Business	A special survey on how business in Europe will change now that 1992 is approaching quickly and January 1, 1993 is the scheduled date when everything is scheduled to change. The lengthy survey notes surprisingly that much of the backlash against Europe 1992 is coming from the leaders of European industry, who were supposed to be the strongest supporters of a single market. Topics covered include product standards, alliances in Europe against Japan and America, problems in eliminating protectionist policies, subsidization of State run businesses, etc. Must reading for individuals interested in the strengths and weaknesses of Europe 1992.	The Economist June 8-14, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730
Americas Banking Muddle	This is a well written summary of recent initiatives in Congress to "reform" the U.S. banking structure. Congress hurriedly put together legislative proposals before the August break against the background of record bank failures, rising deposit insurance costs and the story of BCCI's doings. The article notes that three basic issues have been raised by America's deregulation of financial services over the past 15 years. First is whether banks can be made more solvent by letting them into different businesses such as securities and insurance. The second is how to finance the almost limitless deposit insurance program and the third is how to disentangle the batch of many bank regulators. Although the insolvency of the deposit insurance fund is supposedly at the heart of the debate covering banking reform, the proposals are the least radical in this area. Basically, they try to make it cheaper to force troubled banks into bankruptcy. The Senate Banking Committee apparently wants to make it clear that after 1995 no bank will be considered too big to fail. Given the banks limited success in getting additional insurance powers and the problems non banks will have in owning banks under the Senate proposal, the writers believe there may be little chance for legislation this year.	The Economist August 10-16, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730

Item	Description	Source
The Reckoning	This article covers the recent political and economic scandal in Japan. It notes that basically 17 Japanese securities firms have admitted that they paid clients to cover the clients' losses in the stock market Crashs of 1987 and 1990. The government is now working on legislation to tighten up Japan securities laws in the extraordinary session of Parliament that started on August 5. The practice of offering compensation for losses was claimed by the Ministry's securities division to be improper but not illegal. The Japanese tax authorities are taking a different view. The two methods used to compensate clients were dealing in Japanese government bonds at favorable prices higher or lower than appropriate market prices or buying back warrants at inflated prices in London. The drafted revision of the securities law would ban compensating customers for losses whether promised or not. It would be illegal both for investors to receive compensation and for securities firms to pay it. The article notes the momentum now being established calling for an independent watchdog in Japan like America's Securities and Exchange Commission.	The Economist August 10-16, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730
SIA 1991 Fact Book	Second annual directory offering a decade of data covering global and domestic capital markets and the securities industry in general from 1981 to 1990. The Fact Book provides answers to the most frequently asked questions on the securities industry, stock exchanges, brokerage firms, mutual funds, futures and options, retail and institutional trading and holdings, economic data and foreign market statistics.	SIA 120 Broadway-35th Floor New York, NY 10271 Cost: $25 SIA members; $50 for non-members.